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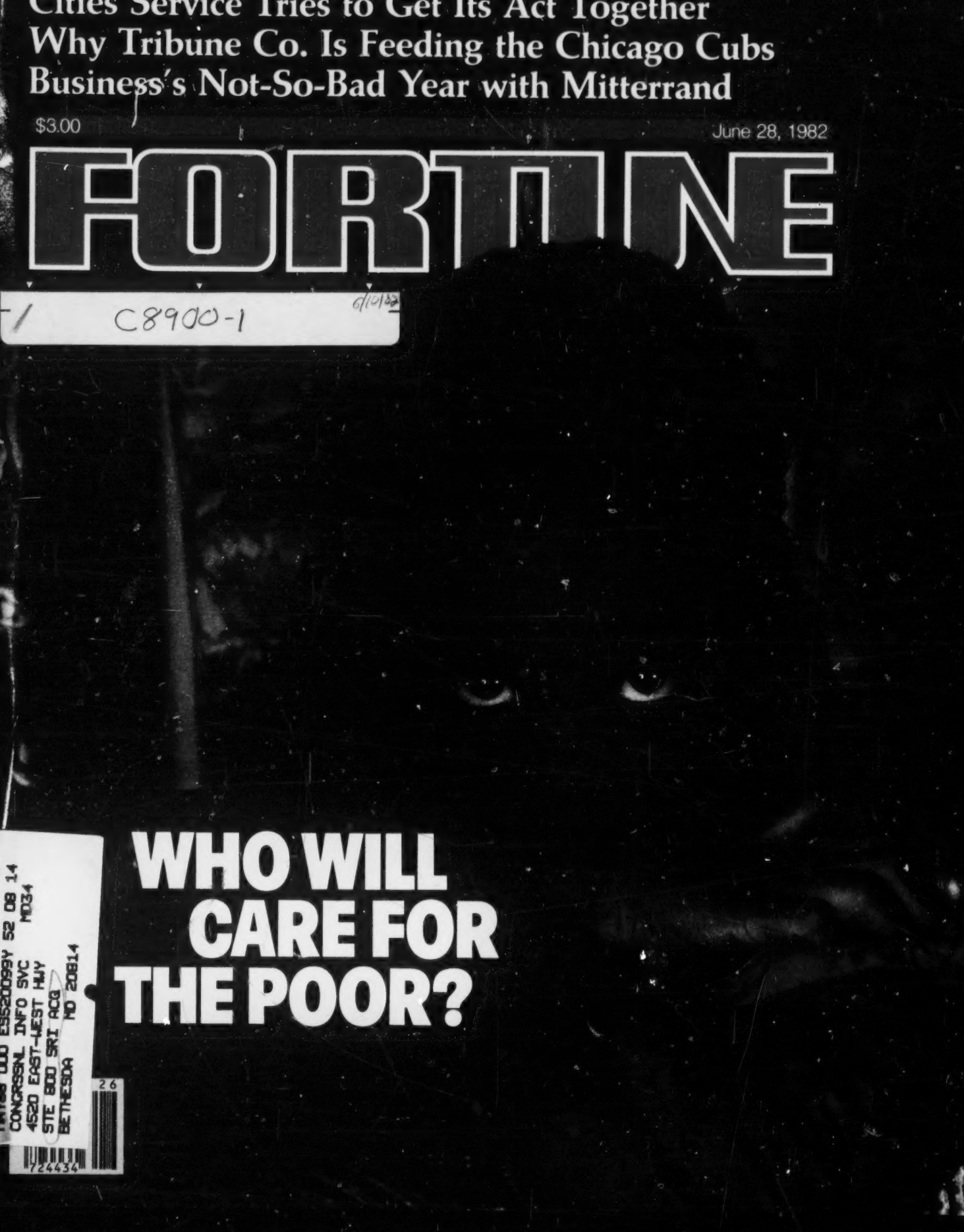

WHO WILL CARE FOR THE POOR?

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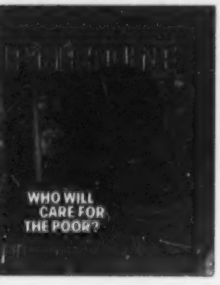

Charles Thorne, 9, lives on welfare with nine other members of his family in a shack in Mound Bayou, Mississippi, where he was photographed for the cover by Charles Harbutt. The future of the programs that support families like the Thornes is explored in the article on page 34.

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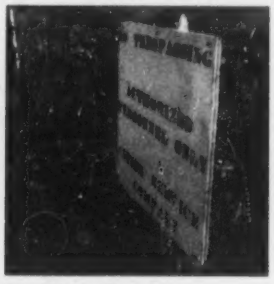

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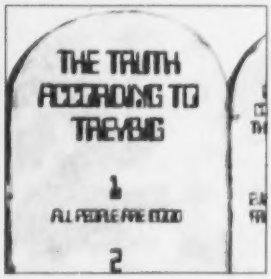

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Reagan's federalism would thrust responsibility for them onto the states. But some things in our society only Washington should do.

POLICY

Who Will Care for the Poor?

by WALTER GUZZARDI JR.

The capitol building in Jackson, Mississippi, has been undergoing restoration for several years now, and the state legislature meets in Central High School, just a couple of blocks away. An undistinguished red-brick structure, Central High appropriately sits in the center of Jackson—a flat, hot, pleasantly passive Southern city of 203,000 whose stores in the decayed downtown section have "Come In, We're OPEN" signs on hopeful display. Unexpectedly close to the dying core, magnolia-shaded houses of fading gentility display their charm and grace. Jackson may be only a middle-size capital, but the issues discussed at Central High recently have large dimensions. Broadly construed, they amount to nothing less than a test of President Reagan's plan for federalism—a test of the wisdom, that is, of turning over to states a wide range of social functions now discharged by the national government.

It seems unlikely that anyone in the Administration gave Central High much thought when the President, in his State of the Union message, reopened the complicated and deep-rooted subject of federalism. Then as now, more immediate questions filled minds and headlines, and Reagan's unexpected introduction of his "cherished dream" was looked on with distrust. He was accused of trying to distract attention from his domestic troubles, and of promoting under an elegant philosophical cover the dream that critics think he really cherishes—to cut social spending, and especially spending for the poor.

Research associate: Rosalind Klein Berlin

While these suspicions probably have some merit, the issues that Reagan raised are far more than just a feint. The President's proposal would make fundamental changes in the way the country is governed. His thesis has important deficiencies, but it is also thoughtful and provocative. Since he has advanced his ideas, they have been challenged on all sides—by Congress, the states, and the cities—and negotiations got hot enough recently so that David Stockman hastily backed off from testifying about the subject on the Hill. Clearly, Reagan's proposals are not going to be enacted as they stand. But his platform will remain the basis for a continuing national debate about the reorganization of public life as we adapt to newly recognized limitations.

Sound the retreat

The principal force of Reagan's argument comes from the hopeless overextension of the national government today. With a style and grandeur that transformed the fiscal foundations of the republic, the federal government for 20 years has poured out grants-in-aid to states and localities until scarcely a function remains at those levels that Washington doesn't own a piece of. For two decades federal grants grew after inflation at an average annual rate of 10%; in fiscal 1978 they hit a high of 17.3% of federal outlays. Last year grants ran to around $95 billion, or 14.5% of federal outlays.

The commendable purpose of the flow was to meet public needs. But in time the voice of states and local governments in determining those needs was all but drowned out in the roar of and the fight for federal money. Recipient governments became heavily dependent on the openhanded federal presence that, ambivalently, they both invited in and wanted out.

And now budgetary pressures make it imperative for the feds to get out. By some estimates federal domestic outlays will be reduced by 6% this year. And if the President gets even part of his way in the resolution of the budget, bigger reductions are coming.

In his State of the Union message President Reagan seized the opportunity offered by this economic reality to lay down his federalist principles. Reagan did not mention the *Federalist Papers*—as a great communicator, he probably feared the soporific effects—but the historic relevance remains. Once, our dual republic ascribed to the central government the encouragement of what the *Federalist Papers* call "the prosperity of commerce." Nurture of what one scholar describes as "civic virtue and public spiritedness," however, was left to the states. But since New Deal days, the government in Washington has become both the principal agent for commerce and the main protector of these values. To those tasks the Great Society added the objective of greater equality.

As a true conservative, Reagan rejects much of that doctrinal liberalism. His comment that people can "vote with their feet" by moving away from poorer states shows that state-to-state inequalities hardly trou-

continued

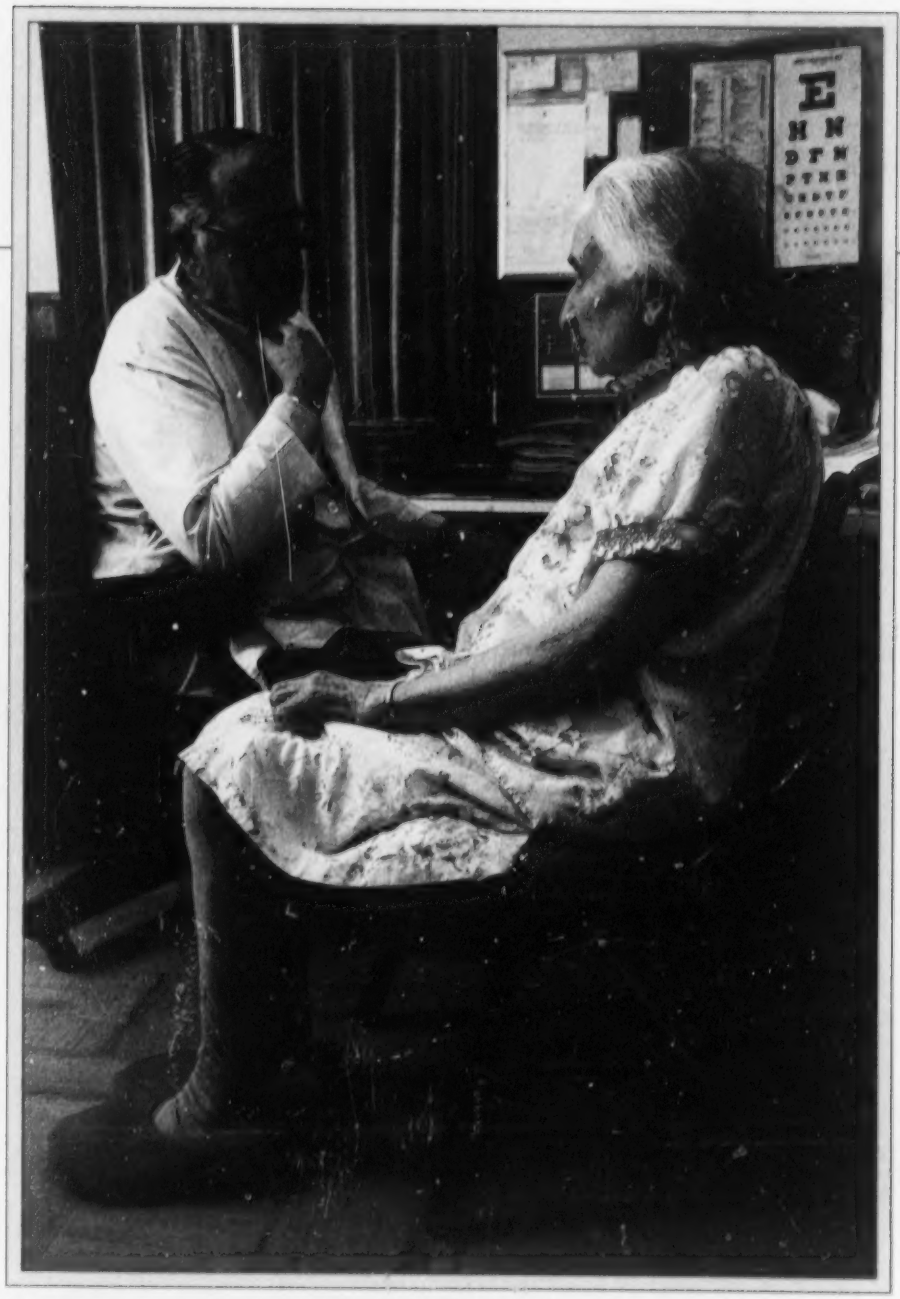
Poor People in the Poorest State

Verine Thorne of Mound Bayou, Mississippi, has double trouble: she is both a welfare mother and a welfare grandmother. Right now she gets $120 in welfare payments for herself and her five children. Her daughter Kathy Ann, who lives with her mother and has three kids under 4 years old, gets the same amount. Together they get $427 a month in food stamps. Mrs. Thorne, 46, chopped cotton from the age of 9 until four years ago, when she could no longer find work. "Anyway," she says, "I can't cut it no more." She pays $60 a month in rent for a broken-down, fly-blown shack in Mound Bayou, and doesn't know who the owner of the place is. Mound Bayou is an all-black community of 2,917; one person out of three there gets welfare payments or food stamps or both.

Photographs by Charles Harbutt–Archive

Care That Costs $1 Billion

In the Samaritan Home in West Bend, Wisconsin, about 200 of the 250 patients are on Medicaid. Most are old people like Anna Rolf, 89, who is being examined by Dr. Frederick I. Bush, 66, the medical director. In Wisconsin, Medicaid costs about $1 billion a year.



ble him. He displays far greater concern for the inequality between the national government and the states. Bureaucratic overcentralization, rather than social and economic inequalities, thus becomes Reagan's first enemy.

Acting on that conservative faith, Reagan would reverse the direction of recent decades and push a lot of government out of Washington. One radical change would transfer to states a large number of federal programs, which in 1981 cost about $40 billion, along with revenues from some existing federal taxes to pay for those programs. Then gradually the federal government would reduce its taxes, leaving states to decide whether the programs were worthwhile, and whether they wanted to apply their own taxes to carry them on.

Reagan would also transfer responsibility for welfare payments and food stamps, thus handing the states the leading social dilemma of our time. Of present supports for the poor, only Medicaid would be run by the federal government; all else would be out where the President thinks it belongs: as he says, "closer to the people it serves." In Reagan's total scheme, programs that cost some $96 billion last year would be switched around. After the full turn of Reagan's devolutionary wheel, the role of states in determining and filling public needs would be greatly enlarged, the federal role would diminish, and some government functions would wither away.

A test of character

Whether such a grandiose redistribution of the social functions of government would work depends in part on the character of state governments—it depends in part, symbolically speaking, on how well they have been doing in the anything but grandiose school auditorium in Jackson, Mississippi. Beyond that consideration, though, Reagan's effort ultimately requires a judgment about what the values of our society are, and whether state governments should be the ones to define those values and give them expression.

Despite all the myths, the competence of state governments is now surprisingly high, and looks better yet when compared with Washington. Since the Supreme Court's "one man, one vote" decisions starting with *Baker* v. *Carr* in 1962, every state has reapportioned its legislature. In the round, the result today is that the black minority is better represented in state houses than it is in the U.S. Congress. Blacks are now 11.7% of the U.S. population. The U.S. Senate has no black members; of the 435 voting members of the House of Representatives, 17, or 3.9%, are black. In the state legislatures, taken together, blacks constitute 4.4%. In Maine and North Dakota, where the black population is tiny, there are no black legislators. In Alabama, where blacks make up 25.6% of the population, their share of legislative seats is highest, 11.4%.

The once antiquated machinery of state government has also undergone extensive overhaul. Almost all state constitutions have been brought up to date in the last couple of decades. Legislatures used to meet so infrequently that sessions were something of an event; now, most con-

A few states remain retrograde monsters, but most have changed their ways.

vene every year. State legislatures have strong staffs that can draft clauses with the best of them in Washington. No one has yet devised a yardstick to measure corruption, but evidence doesn't support the legend that state governments are rotten with vice. The worst scandals of recent years have coiled around Capitol Hill.

The days of the pass-the-biscuits-pappy orators with string bow ties may not be entirely gone, but many states now have low-key, first-rate governors, some of whom make more sense than recent Presidents. William Winter, the governor of Mississippi, could hardly be more remote from the Southern pol of old: a well-educated, scholarly man, his chief weakness as a politician seems to be that he is too evenhanded. Richard Snelling of Vermont, a cum laude graduate of Harvard, is the dominant voice in the National Governors' Association, of which he is chairman.

In Mississippi, and in 45 other states, governors are now elected for four-year terms. Most can succeed themselves; all have veto power except in North Carolina. By yet another measure of democracy, states beat Washington by a provincial mile. Referendums in states are increasingly common: Alaska has gone to the voters for a judgment about mandatory deposits on containers, and California for a verdict on smoking in public places.

"Tax and tax, spend and spend"

Intricacies and absurdities are present in the way states run their fiscal affairs, but at least most work from understandable principles—and anyway, it would be hard for any state to do worse than the U.S. Congress is doing right this minute. All state constitutions except that of Vermont—a state not likely to lose its head—require their governments to balance their operating budgets every year. States run separate budgets for capital expenditures, and they can borrow for those purposes. Many states appropriate federal grants into their budgets, just as though they had raised the money themselves. Relative to Congress, that looks pretty good: states do not, and cannot, in the old phrase, "tax and tax, spend and spend, elect and elect."

When it comes to the ways they raise revenues, a few states remain retrograde monsters, but most have changed their ways. Forty-three impose personal income taxes, some tied to the federal tax system. Forty-five have sales taxes. Together, income and sales taxes make up 70% of the revenue raised by states, which seems a respectable proportion. And states have checked excessive reliance by local governments on the regressive property tax by clamping on ceilings or devising rebates.

Regional favoritism toward the wealthy, however, detracts substantially from this encouraging picture. When it comes to taxing, Southern states give more consideration to well-off people than to residents in general. In Mississippi the top tax rate on income is 4%, reached when taxable income exceeds $5,000 a year. From then on, the "progressive" nature of the tax stops for individuals and for corporations. In 1980 Mississippians paid $9.18 per $1,000 in personal income taxes, half the national average, while they paid sales taxes, less onerous to those well off, of $41.05 per $1,000, twice the national average.

In Jackson, anyway, that reluctance to tax translates into a reluctance to educate. Mississippi is the only state not to have kindergartens as part of public education. Governor Winter this year tried to increase the state's "severance tax"--a tax imposed when natural resources such as oil are "severed" from the ground, paid by the producer, and in large measure passed on to consumers in other states. Winter's case looked strong because the rate of the severance tax had not changed for 40 years, and because he wanted to use the proceeds for kindergartens. Intensively lobbied by the oil companies, and sadly enough influenced by the thought, says one journalist, that "kindergartens would just be day-care centers for black kids," the legislature turned the governor down.

The resistance of voters to spending increases, which partially explains Winter's licking in the kindergarten, was first understood by those running municipalities and counties. During the Sixties and early Seventies, state and local spending was a high-growth industry; in 1975 the two kinds of spending touched a high of 11.4% of GNP. But then voters raised their exasperated voices, and localities were quick to respond. They began to reduce per capita spending in real terms in 1975. Next to heed were the states: their spending spree ended in 1977. But the flow of funds from Washington to those governments kept growing until 1979. That year, the federal government gave states and localities 31.3 cents for every dollar they raised from their own sources. In 1980, the figure was down to a still substantial 30.4 cents.

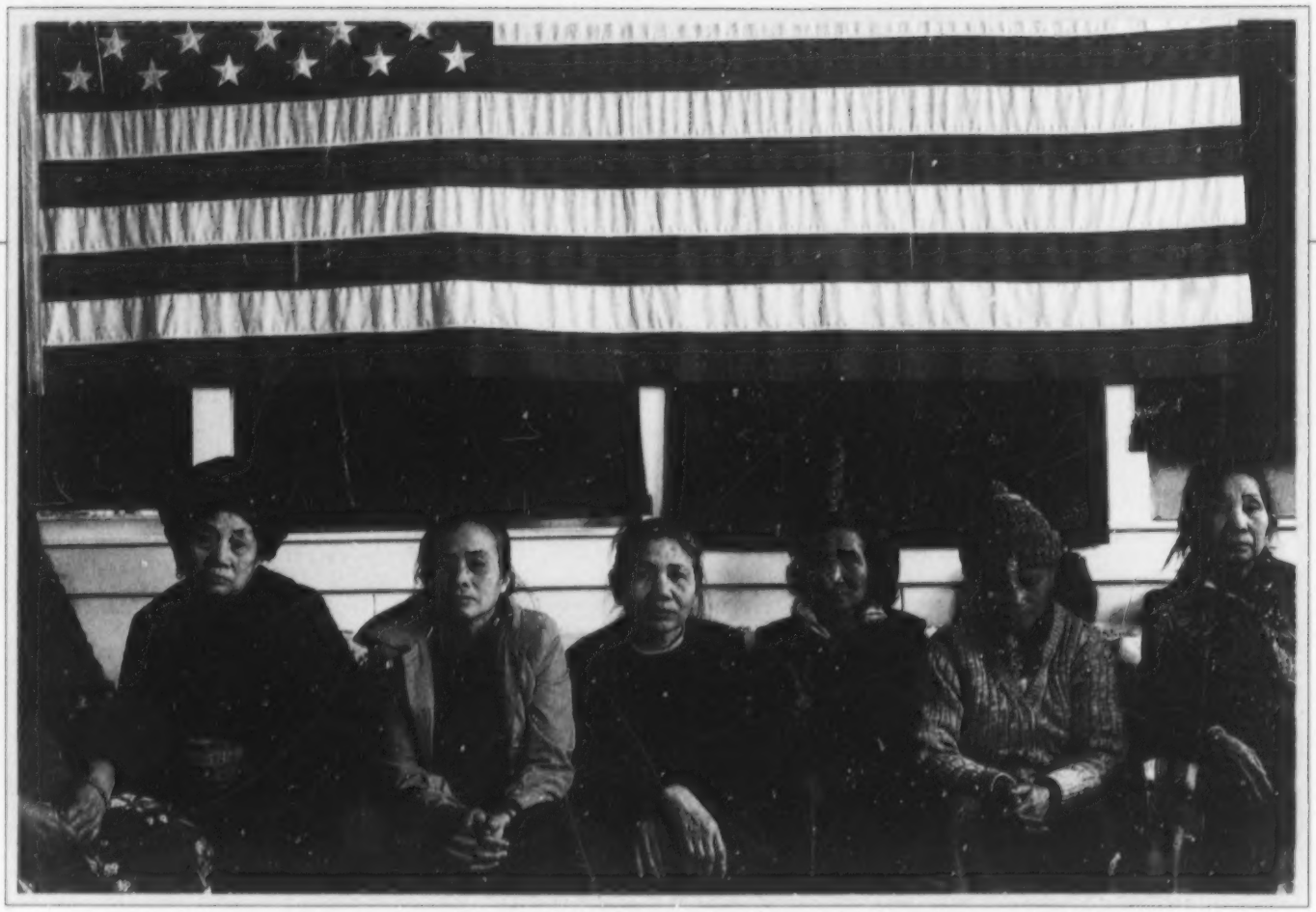
How much would states do?

The general competence and responsiveness of state governments are only part of the test of Reagan's federalist ideas. Beyond are harder considerations about how the poor would be cared for if states were wholly in charge of them. Relevant evidence lies buried in the mechanics of the welfare system and in measurements of the will and the capacities of states.

In the complicated machinery of welfare—officially, Aid to Families with Dependent Children—states play a subsidiary but important role as shapers of policies and dispensers of funds. The federal government sets the general criteria of eligibility, but states have latitude in deciding how much in the way of assets can disqualify a welfare applicant, for example. More important, states determine the amount to be paid to each welfare family.

The payment is made up of dollars from Washington and dollars raised by states, although in a handful of cases where big cities have special importance—New York is the leading example—local governments also contribute. Washington's share of the payment declines as the ratio of a state's per capita income to the average per capita income in the nation increases. At present it varies from 50% to 77% of a family's welfare payments. Administrative costs are divided equally between the two levels of government.

The striking contrasts that result from this curious hybrid born of political com-



The Sorrow of Laotians in Seattle

These Laotian refugees in Seattle await food parcels from a charitable agency. Federal aid to the refugees is ending, but both Seattle and the State of Washington believe they should remain a national responsibility.

promise can be seen in the wonderfully cautious ways of hot Jackson, Mississippi, as compared with the stunning generosity that governs in cool Madison, Wisconsin. The legislature in Jackson has fixed the lowest payments in the country, authorizing maximum welfare payments of $96 a month for the typical welfare family of three (see table on the facing page). Since Mississippi's average per capita income of $605 a month in 1981 was also the lowest in the country, the federal government paid 77%, or $74 of that $96. The payment of $96 amounts to 16% of the state's average per capita income. But the state's share, $22, is only 4% of per capita income.

The model state of Wisconsin looks at a different world with a different eye. Welfare payments there come to $473 for a family of three. The state's average monthly per capita income was $838 in 1981. On that basis, the ratio of payment to income is 56%, against Mississippi's 16%. Wisconsin's share of the $473 welfare check is $199. On *that* basis, Wisconsin is paying 24% of per capita income, compared with Mississippi's 4%.

Rush not to judgments, ye who enter here. History's influence, cultural patterns, and the mix of population are all determinants of a state's attitude, and no calculus yields conclusive information about good or bad, right or wrong. In Mississippi, the poor, who are mostly rural, make up 25% of the population, the highest proportion of any state in the country. To help them, the state will spend $212 million of its own funds this year. And in that once openly racist state, 86% of the people helped by welfare payments are black.

In Wisconsin the social fabric is entirely different. The state has always been in the vanguard of social programs: it was the first state to impose a progressive income tax, and started education for the handicapped before the federal government did. But then—Wisconsin has rich farmlands, sizable industry, and a high literacy rate. Blacks are only 3.9% of the population, concentrated in Milwaukee; only 8.5% of the total population is poor. One quarter of Wisconsin's budget goes to help the needy, while Mississippi spends one-sixth of its budget for the same purpose. But given all the differences between the states in resources, culture, and financial needs, Mississippi is not greatly to be faulted.

The complexity of the relationships of states to welfare multiplies when it comes to Medicaid. By federal law all recipients of welfare checks are eligible for Medicaid. Federal law also mandates coverage for certain services, but states may increase the benefits beyond these minimums. Generally, payments for Medicaid are covered by the same formula as the one that

A Gamut of Generosity

President Reagan's suggestion that responsibility for welfare and food stamps be turned over to the states has raised questions about how the poor would fare under such a system. One indication is the contributions that states now make to the poor. The dollar amounts of welfare payments to a family of three are set by each state. The table shows what those amounts were in November 1981, and how much of that was put up by the state as opposed to the federal government. By themselves, though, the absolute amounts don't tell much about a state's generosity, since resources and per capita incomes vary widely from state to state.

One way to judge a state's concern for the poor is to compare its contribution to welfare with its average monthly per capita income. By that measure, New York is the top performer. The Southern states generally are underachievers.

The Advisory Commission on Intergovernmental Relations, a research organization, assesses generosity in a different way. ACIR believes that per capita income, while an accurate reflection of a state's well-being, is not always a reliable indicator of taxing capacity. ACIR puts together all potential sources of a state's tax revenue, such as personal income, retail sales, and natural resources, and computes per capita tax potential. That potential is shown as "state tax capacity" (blue dot) in the right-hand column. A state's "tax effort" (red dot) is based on the ratio of actual tax collections to tax capacity.

Despite its high per capita income, New York has a below-average tax capacity. But its tax effort is the highest in the country. When looked at along with the state's high welfare payment of $507, the indices pretty clearly show that New Yorkers are heavily taxed to help the poor. Texans, however, are unmoved by similar impulses: their tax capacity is the fourth highest in the country and their tax effort the second lowest. The social attitudes of Texas are congenial to Wyoming, where the nation's second-highest tax capacity supports the fourth-lowest tax effort.

The blue arrows used for Wyoming and Alaska indicate taxable wealth so high it runs off the chart.

	Monthly welfare payment	State share	Share as percent of per capita income	● State tax capacity ● State tax effort BELOW AVERAGE ABOVE
Alaska	$571	$286	24%	
New York	$507	$249	26%	
Vermont	$506	$159	22%	
California	$506	$253	25%	
Connecticut	$498	$249	23%	
Wisconsin	$473	$199	24%	
Hawaii	$468	$234	25%	
Michigan	$464	$232	25%	
Minnesota	$446	$203	23%	
Washington (State)	$415	$208	22%	
Massachusetts	$379	$176	19%	
Rhode Island	$367	$155	18%	
Iowa	$360	$161	19%	
New Jersey	$360	$180	18%	
Kansas	$353	$168	19%	
Nebraska	$350	$147	17%	
Utah	$348	$109	16%	
Oregon	$339	$160	19%	
North Dakota	$334	$127	14%	
Pennsylvania	$332	$143	17%	
New Hampshire	$326	$132	16%	
South Dakota	$321	$102	14%	
Wyoming	$315	$158	16%	
Colorado	$313	$149	16%	
Virginia	$310	$134	15%	
Idaho	$306	$105	14%	
Illinois	$302	$151	16%	
Maine	$301	$ 88	12%	
Oklahoma	$282	$113	13%	
Montana	$278	$ 90	12%	
Maryland	$270	$135	14%	
Delaware	$266	$133	14%	
Ohio	$263	$118	14%	
Indiana	$255	$110	12%	
Missouri	$248	$ 98	12%	
Nevada	$241	$121	12%	
New Mexico	$233	$ 76	11%	
West Virginia	$206	$ 66	9%	
Arizona	$202	$120	15%	
Florida	$195	$ 82	10%	
North Carolina	$192	$ 62	9%	
Kentucky	$189	$ 60	9%	
Georgia	$183	$ 62	8%	
Louisiana	$173	$ 57	7%	
South Carolina	$129	$ 38	6%	
Arkansas	$122	$ 34	5%	
Tennessee	$122	$ 38	5%	
Alabama	$118	$ 34	5%	
Texas	$118	$ 42	5%	
Mississippi	$ 96	$ 22	4%	

The behavior of states toward the poor is a trip from Jackson to Juneau.

governs welfare. Under its Medicaid program, Mississippi does not go much beyond what the government mandates. The state portion of the payout comes to around 23 cents of every dollar spent on Medicaid there. That may sound low, but Arizona, exercising its sovereign right to turn down federal money, has no Medicaid program at all.

Up in Wisconsin they might have done better to control their generous instincts a bit along Arizonan lines. Wisconsin offers just about every kind of Medicaid service, with the result that, admits Donald Percy, the state's director of health and social services, "our costs are now out of control." Wisconsin spends $440 million a year of its own funds, or $108 per capita, on Medicaid; Percy predicts that the sum will be $14.3 billion in 20 years if the growth is not checked. Giving less as Mississippi does, or nothing as Arizona does, may be easier than taking back what has been given, as Wisconsin now must do.

Balm from Big Brother

Food stamps, a kind of balance wheel in the welfare scheme, break out of the mold of hybrid services. They are entirely paid for by the federal government, and eligibility, determined in Washington, is based on the single criterion of income. The dollar value of the stamps that recipients get is based inversely on the size of their welfare payments, less deductions for medical expenses and certain other costs. Tying food stamps to welfare payments in that way allows states making low payments to rely on Washington for balance. In New York, where welfare payments for a family of three come to $507 a month, second highest in the country, the value of food stamps for the same family is $100. But in Mississippi, that $96 welfare check is supplemented, to put it conservatively, by food stamps worth $183. States may decide not to try as hard as they might because free balm for their consciences is always en route from Washington.

The question of just how hard a state *should* try may belong in Solomon's lap, not Reagan's, but ways of measuring how hard they *do* try can be enlightening. The Advisory Commission on Intergovernmental Relations, a congressionally financed body that leads the research in this field, judges a state's "tax effort" by measuring its actual tax collections against all its potential sources of tax revenue (see table on the preceding page). Looked at that way, the legislators in the school auditorium in Jackson aren't performing badly. Mississippi has the lowest taxable resources in the country. But the tax effort coming out of Central High stands close to the national average. By contrast, Texas, with all its lovely oil and natural gas, has a lot of taxable wealth. But Texans and taxes don't mix: their tax effort is the lowest in the land. Of the rich states, Alaska seems the one with the heaven-sent quality of mercy: both its tax wealth and its tax effort are far above average.

In the panoptic view, then, while state governments seem reasonably competent, their behavior toward the poor shows only diversity and no generality: it is a trip from Jackson to Juneau. Against that variegated background, what can one make of Reagan's grand scheme for devolution?

The most promising part of Reagan's realignment comes with the proposal for radical reform of the increasingly unsatisfactory grant-in-aid system, which has reached heights of complexity that dizzy the mind. By moving that big slice out of Washington, Reagan would take advantage of the states' new abilities, while correcting the federal government's deficiency. All our experience with the brotherhood of social engineers suggests that the federal government must stop specifying and prescribing for all social needs. Reagan's corrective would give 40-odd federal programs, many tightly controlled, to the states to run. Right now those programs are overlapping, bewildering, and at a total of some $40 billion, very costly. Last year they were paid for by 125 separate grants, and aimed at groups of beneficiaries described in tables that sort out people as though they were different kinds of vegetables. Included in the programs are such items as "metric education," "summer feeding," "career education incentives," "special meal assistance," "hypertension"—enough to make a marvelous Gilbert and Sullivan aria.

For Congress to spend days debating the proper nutritional balance for a school kid's lunch is surely a dispensable absurdity. Democratic Governor Bruce Babbitt of Arizona has said that Congress "ought to worry about arms control and defense instead of potholes." In that case Babbitt thinks "we might just have both an increased chance of survival and better streets."

Reagan's program would also turn back the federal invasion of cities, and that too seems a good idea. Direct federal grants to localities came to around $20 billion last year—half the $40 billion in all grants not directly connected to payments for the poor. Samuel Beer, the noted Harvard political scientist, says the establishment of that federal-government-to-city relationship "was without precedent in the American or any other federal system." Federal grants have blanketed almost every urban activity, and have often left city governments overwhelmed. In El Paso, Texas, eagerness to start projects that qualified for federal money led to big annual increases in the city budget in the early Seventies. Then when Congress ended countercyclical revenue sharing, El Paso was forced into a fire sale of city land to keep afloat.

Gripes from the mayors

Reagan would head off such problems by virtually ending the direct Washington-to-cities link and interposing the states between the federal government and the cities. The idea troubles mayors, who with considerable justice say that the neglect of urban areas by states was what brought the feds into the act in the first place. Mayors also properly point out that state legislators like to give everybody in the assemblage a little something to take home, with the result that some cities, of which Baltimore is notable, come out on the short end. On balance, though, in the light of all those costly federal failures, a restoration of the traditional ties between states and cities looks more promising

A Black Caucus in Mississippi

Mississippi's legislature has 17 blacks. David Green (standing), 30, deals with welfare. Another leader, Aaron Henry (dark suit, facing camera), 59, thinks federalism is as good news for Mississippi as Grant's siege of Vicksburg.

than just more, or a little less, of the same old thing from Washington.

On the whole matter of grants, however, Reagan's federalist ideal clashes with present hierarchies of power. Congressmen like credit for spending federal money back home. Reagan himself lost a passage of arms with Congress last year when he tried to consolidate grants costing about $16.5 billion into seven blocks. Congress pared down important parts of the proposal. In the end, according to Richard Nathan, a former OMB official who is now head of Princeton's Urban and Regional Research Center, Reagan's plan was "reduced in amount and diluted in purity."

In addition, the specifics of Reagan's idea for transferring programs and a trust fund to states have run into a good deal of trouble. Reagan wanted states to take over those 40-odd programs and carry them on, if they wanted to, with revenues from taxes that the federal government would gradually give up. But his claim that no state would suffer financial loss in the transition is disputed by many state governments. Also, considerations of equity have yet to be addressed: states do not have equal capacities to raise money by the taxes that the federal government would be relinquishing, and need may be greatest where capacity is lowest. For example, the windfall-profits tax, which was intended to make up part of the fund, is significant only for the eight states that are the big oil and natural gas producers.

When it comes to his dramatic and unexpected proposal for turning the country's poor over to the states, though, Reagan's devolutionary plan is shot full of shortcomings, which may be explained by his old ideas about the poor and about where social obligations lie. The idea with merit, perversely enough, recommends not devolution but centralization. Right now, Medicaid is a formula for disaster. The certainty of incoming money from Washington in amounts greater than they put in themselves has led states—remember generous Wisconsin—to expand coverage heedlessly. And on the federal side, the sky's the limit: federal expenditures can't be capped, and congressional review is discouraged because nothing less than rewriting the law can check costs anyway. Further, states whose contributions are only 25 cents or so on the dollar—remember skimpy Mississippi—have little incentive to track down abuses: they pay half the administrative costs of the tracking, while 75% of what they save goes to the U.S. Treasury. So Medicaid, which started in 1966 at $363 million, cost $30.4 billion last year—more than twice as much as welfare payments, and 2½ times the cost of food stamps.

continued

The real "welfare mess" does not come from waste and fraud, but from welfare's hybrid nature.

If Medicaid were centered in Washington, at least the chance for control would open up. The horrendous "sky's the limit" character would change once mandatory matching of state money was ended. And on a nationwide basis, the range of covered services could be reduced: the federal government could not possibly pay for everything that the most generous states now offer—"that would be a break-the-bank proposition," says Kenneth Howard, for four years Wisconsin's budget director, who ought to know. To take away from people what they have become accustomed to being given would cause an outcry. Unfortunately, the outcry would be loudest in states that have been doing the most, since beneficiaries there would be losing the most. But there's no way out of the morass that doesn't hurt somebody.

The protests might be muted if a move to Washington restored some much needed equity to Medicaid, which is now as unfair as it is costly. At present, some poor people are excluded from Medicaid because, for one reason or another, they are not on the welfare rolls. On the other hand, according to the Congressional Budget Office, over five million people eligible for Medicaid have incomes twice the poverty level or higher. Extreme state-to-state variations in amounts spent—from zero in Arizona to $1,985 per recipient per year in New York—reinforce the arguments for uniform standards and administration. Also, Medicare, the medical program for the elderly, is run from Washington, and the two programs belong together.

A striking antithesis

Those marshaled arguments in favor of Reagan's contention that Medicaid belongs in Washington, however, cut forcefully *against* Reagan's desire to turn welfare over to the states. The antithesis is so striking that it has added fuel to speculation that the President doesn't care about the poor. Reagan can suffer the idea of having the national government give poor people medical care by paying those who profit by supplying it to them, runs the rationale; what he can't stomach is the idea of just handing them money.

Of all the moral entanglements of welfare, none is more troublesome than the unequal treatment given by that costly effort to help poor people. Oil-rich Texas, for example, makes the second-lowest average welfare payments in the U.S. after poor Mississippi. The payments in Texas actually fall short of the level of need set by the state itself. To turn welfare entirely over to the states would ensure that such inequities, already a discredit to a creditable national effort, would multiply. Economies of states swing more widely than the national economy does, and to some degree the well-being of states is determined by policies in Washington and other factors outside state borders. To tie care of the poor to that roller coaster every year is unconscionable. Further, Richard Nathan of Princeton believes that if they had to bear the entire welfare burden, states would step up their competition to hold down benefits and tighten eligibility.

Right now, the unequal benefits are not marked enough to touch off migrations. People apparently travel to look for jobs, go on welfare when they can't find them, and then, if they are in a state where benefits are high, tend to stay there—caught in "the welfare trap." But should the difference in payments grow sufficiently, migrations toward welfare might begin. Imbalance in jobs and growth patterns could follow—"bad economics, and far from the free market that Reagan says he wants," comments Nathan.

Perhaps the strongest argument for turning welfare over to states comes from Reagan's own belief that "there's much more chance of waste and fraud in trying to run welfare from the national level than there is in running it at the local level." Despite that reasonable assumption, though, the real "welfare mess" does not come from waste and fraud, but from welfare's hybrid nature, which makes it impossible to hold any single government responsible for handling welfare well or badly. In any case, to weed out cheats is not to effect reform. The principal accomplishment of Reagan's devolution in this field would be to disencumber the national treasury of a heavy burden—but only by fragmenting the burden and shifting it elsewhere.

The rest of Reagan's initial scheme for federalism calls for turning over food stamps to the states. But the determinant of who runs food stamps should depend on who runs welfare, which food stamps support. The principal defects in food stamps arise from their being fully paid for by Washington but distributed by state and local governments. When funding and administration are thus divorced, restraint and frugality find no sponsor.

Fitted for a straitjacket

Anyone proposing with certitude that to place costly, trouble-ridden, Washington-invented, Washington-shared programs wholly in the hands of Washington would improve them is sure to attract measuring glances from tailors of straitjackets. Still, more evenhandedness could result from national standards of eligibility and nationally determined levels of payment. Further, the curse of matching grants, which compels the feds to match state dollars endlessly, could be removed. Administration could be centralized, offering a bit of hope, anyway, that some of the present schizophrenia and the costs that go with it would be corrected.

On balance, Reagan's ideas, commendably, would reduce the federal role in important ways. But where they fall short in humanitarian terms, they would make us less than we are. *Federalist Papers* or not, in modern times the expressions of our highest values—our desires to stay free, to eliminate racism, to care for the elderly and the poor, to let ideas compete freely—have come from the national government and from national leadership. Those values cannot be fixed at the Office of Management and Budget. Nor can their defense or enlargement be entrusted to 50 little republics with uneven resources, with limited control over their own prosperity, with borders that make no modern sense, and with environments that can narrow minds. Even if these little republics are competent, our values transcend them. F

OIL

Treasure Hunt at Cities Service

by PETER NULTY

It's a commonsense axiom in the takeover game that unwanted suitors are attracted by large hunks of real assets—spare cash in the bank, say, or proved energy reserves in the ground. The lure of Cities Service Co., however, is buried treasure that may or may not exist. With revenues of $8.9 billion, the Tulsa-based company last year was the 19th largest in the U.S. oil and gas industry, but it holds the sixth-largest cache of undeveloped domestic land—10.6 million acres under lease. No one knows how much of that land is energy rich and how much is just, in industry parlance, "moose pasture."

Nevertheless, T. Boone Pickens Jr., 54, the chairman of Mesa Petroleum, is dying to get his hands on it. Last week he announced he was willing to pay $50 per share for Cities stock, then selling at $35.50. Generally, where Boone bets, the moose don't graze. An aggressive exploration company based in Amarillo, Mesa is one of the few U.S. energy companies that have managed to increase reserves significantly in the past few years. Pickens, who sued Cities last year when it fended off his earlier advances, won't discuss what he would do if he got control, but security analysts expect he would hang on to the production properties and the unexplored acreage and sell off a slew of nonenergy businesses as well as many assets in oil refining, marketing, and transportation.

continued

Mark Godfrey—Archive

In past years Cities poured much of its oil earnings into diversification rather than the search for new reserves. This skeleton of an office building near Bay City, Texas, was to have been part of a $300-million plastics complex. In January the company suddenly got out of plastics—writing off $290 million as it went.

Mark Godfrey—Archive

Examining color-coded seismic charts, Chairman Charles Waidelich (right) and President Robert Chitwood are finally gearing up to explore Cities' vast oil and gas lease holdings—a job Mesa Petroleum's chairman, T. Boone Pickens Jr., would like to take over.

Charles Waidelich, 53, chairman of Cities, has done practically everything but mine his acreage to keep Pickens away. Though Mesa's sales—$366 million last year—are less than 1/24 of Cities', Waidelich takes Pickens's taunts seriously. Mesa acquired 5% of Cities late in 1980 and has been trying ever since to arrange financial backing to get the rest. Last summer Waidelich discussed merger with Conoco as a defense, but the talks fell through shortly before Conoco was swallowed by Du Pont. Then Waidelich arranged a $3.5-billion line of credit as a "defense fund." Last September he drew on $300 million of that to purchase a block of Cities shares from Nu-West Group, a Canadian company that Waidelich believed was planning to sell out to Mesa. It was an expensive maneuver—Cities paid a hefty $51 a share, a total of $307 million—but it kept another 7% of Cities shares out of Pickens's hands. Waidelich's latest defensive ploy was a turn-the-tables bid to buy Mesa.

All the fireworks may attract other contestants, but Cities at the moment is no prize. Ironically Waidelich's own plans to shape up the company bear more than a chance resemblance to what is generally regarded as Pickens's scheme. In the past Cities has frittered away money on diversification that might have been more profitably used hunting for oil and gas, and a lot of mistakes came home to roost last year. Only 14 months ago when Waidelich took over as chief executive from Robert Sellers, who retired, Cities had just wrapped up 1980 with a resounding cheer, earning a record $478 million. Renowned as a sluggish performer in the oil and gas patch, Cities' return on equity was a handsome 19% that year and the company was predicting better earnings in 1981. But just when things were looking up, the earnings started disappearing.

Research associate: Wilton Woods

A goal not set

As the oil glut developed and prices started falling, Cities was particularly vulnerable. In the 1970s it scattered its resources in a broad campaign of diversification. It spent $150 million to open a copper mine in Arizona. It put up an iron-pelletizing plant in Tennessee that was closed and written off in 1978 for $160 million. It sank $380 million into the plastics business, and in a particularly ill-timed purchase, it shelled out $77 million for some coal reserves in 1980, just before a spate of coal properties landed on the market. All the while, Cities' reserves of oil and gas, like those of many other companies, were declining. "Sellers always talked as though the last great oil well might have already been drilled," says Philip Wood, who resigned as chief financial officer last year. "They should have set a goal for replacing reserves and stuck to it."

The wisdom of that hindsight was royally bared when oil prices slipped last year. The most profitable sector of the industry these days is domestic oil production. Cities produces only about half its needs. The rest is bought on the open market, where crude prices, although falling last year, were sometimes higher per barrel than prices of refined products. As a result, Cities' profits from refining, marketing, and transportation operations plunged from $203 million in 1980 to $2.6 million last year. The company produces almost all the natural gas it needs and has a highly profitable natural-gas-liquids business, but demand for these products was dropping as well.

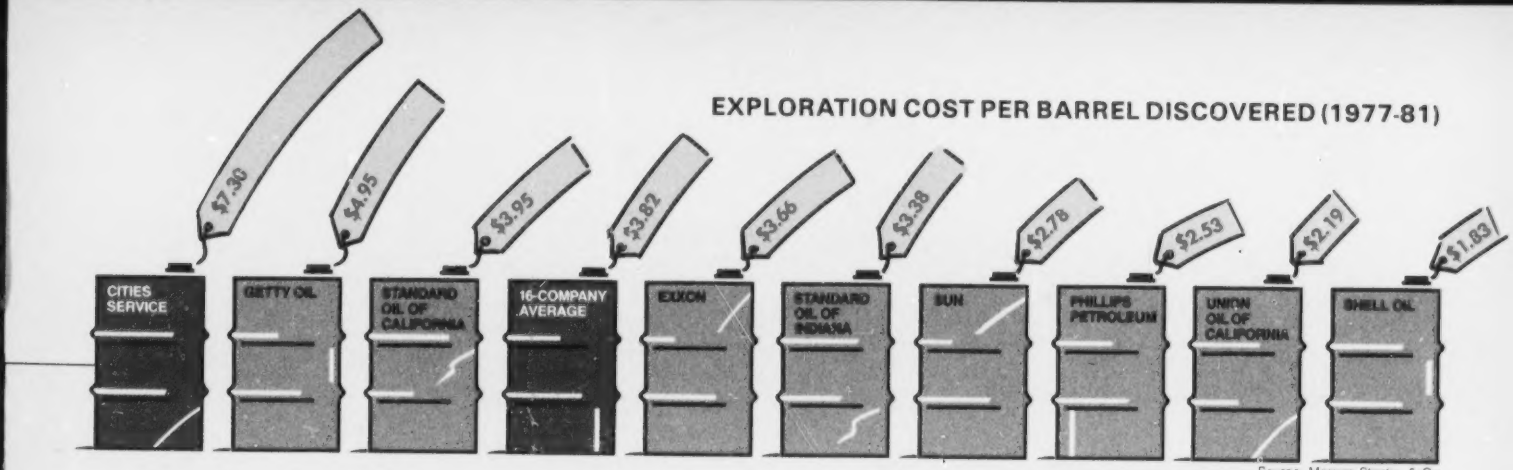
Even leaving aside the specter of a battle with Mesa, Waidelich's year began to look ominous early. In March 1981 the company's estimate of net earnings for the year dropped from $490 million to $400 million, in June to $360 million, and in September to $290 million. The final truth came to rest at $240 million on revenues of $8.9 billion. As cash flow ebbed, Waidelich was forced to increase debt—from 31% to 45% of capital—to fend off Pickens and Nu-West and to keep capital spending on track. Waist-deep in trouble by year-end, Waidelich decided to take a bath. Last January he shut down the money-losing plastics operations and wrote off $290 million. The final tally: Cities lost 60 cents a share, down from earnings of $5.73 the year before.

Much of this pain seems to have been avoidable—the plastics disaster, for example. In the late 1960s, when the plastics industry was growing rapidly, Cities built a plant to produce low-density polyethylene

Cities Service plastics operations

YEAR	CAPITAL INVESTED (MILLIONS)	INCOME/LOSS AFTER TAXES (MILLIONS)
1976	$7.8	$15.8
1977	$8.8	$6.2
1978	$49.4	-$3.3
1979	$88.4	-$13.1
1980	$71.9	-$11.1
1981	$111.1	-$335.6

In the past six years, Cities has poured $337 million into the plastics business while the profits just melted away.



Source: Morgan Stanley & Co.

(used in films and packaging) and hired Philip Wood from Union Carbide to run it. Wood recommended that Cities develop a market niche for its product before expanding, but Cities wanted growth fast. It reassigned Wood to head the corporate-planning department, doubled the capacity of the plant (a project completed last year), and broke ground near Bay City, Texas, for a new plant to produce a high-density polyethylene.

Meanwhile, several chemical companies came out with a low-density polyethylene that was superior to Cities' product. As overcapacity mounted, Cities' losses grew from $3 million in 1978 to $49 million last year. (See the table on the facing page.) And even though foreign oil-producing countries were busily announcing polyethylene plants, as late as last June a Cities Service magazine was promising "coast to coast commitment to plastics," where the "growth potential is tremendous."

Asked why Cities didn't bail out sooner, President Robert Chitwood replies, "Conditions changed last year. We looked at the capital needs down the road and thought, 'My God!' " Philip Wood sees it differently: "They spent $111 million on plastics last year, and then they just shut the SOB down. Things don't change *that* fast." Concurs one security analyst, "Cities has a well-known propensity to bleed awhile before it applies first aid."

While Cities was unable to bring its diversification into focus, it was just as fuzzy about energy exploration. Primarily a domestic producer, Cities began spending a third of its exploration budget during the 1970s looking for a big discovery in unexplored areas overseas. That major undertaking hasn't produced much so far. At the same time, the company was accumulating its enormous portfolio of domestic exploration leases. Although the exploration budget has quadrupled since the oil crisis hit in 1973, it was never large enough for so much land. Reserves can be bought as well as discovered, of course, but Cities hasn't had much luck in the bidding.

If he can avoid being picked off by Pickens, Waidelich plans to sell off the company's Arizona copper mine and the industrial-chemicals plant in Tennessee, and raise whatever he can from selling the plastics assets. The cash from the sales, along with most of the company's other cash, will be dedicated to exploration and production.

Missing the target

Retrenchment is a natural course for a company that has traveled too far afield. But Cities will have to do more than redeploy its assets; it will have to bring more people who understand exploration and production into positions of power and influence in top management. For years the company has been run by executives—Sellers, Waidelich, Chitwood—who came up through the refining, marketing, and transportation side of the company. Cities has done a lot of things right in these areas: it got rid of its old, inefficient refineries over a decade ago and was a leader in switching in the early 1970s from inefficient, full-service gas stations to high-volume, self-service outlets called Quik Marts. But Cities chief executives, when venturing into fields outside their areas of expertise, have either stumbled or hedged their bets to the point of suffocation.

And Cities hasn't been getting results from the money that did go into exploration. In the past five years, the company has spent more money per barrel of oil equivalent discovered than any of 16 companies surveyed by Morgan Stanley security analyst Barry Good (see the price tags on those barrels above). That could mean that Cities scientists aren't hitting their target as often as they should, or it could mean there's more moose pasture in Cities' leases than many people, including Boone Pickens, suspect. Cities claims there is a three- or four-year lag between exploration of a site and the logging of any reserves discovered. The company believes the hefty increases in the exploration budget of the past few years began to be felt in 1981, when 57% of U.S. production was replaced with new domestic reserves. That's the company's highest replacement ratio in years, but it's still below the average of 64% in the Morgan Stanley group. (Last year Mesa replaced 163% of its oil production and 158% of its gas production.)

Now, because of the drubbing Cities took last year, the exploration budget is momentarily stalled again. To compensate, Cities signed last January a deal in which five insurance companies agreed to spend $437 million to explore 8.3 million acres in the U.S. over the next four years.

Just as important for Cities is exploration in frontier regions offshore and abroad. Although foreign reserves are less secure and less profitable than domestic reserves, they may be the only hope for ensuring ample crude supplies for the long run. Cities has leases to explore a number of untried areas in Africa, the Philippines, and Pakistan. Albert Anton, a security analyst at Carl H. Pforzheimer & Co., believes Cities has an excellent portfolio of frontier prospects. "It's an explosion waiting to happen," he says.

Waidelich, who is facing another slow year for earnings, concedes that Cities "needs a big one." A consolation to Cities' shareholders, if not to Waidelich, is that if he doesn't find it someone else might. F

Spending More and Finding Less

In a study of 16 major oil companies, Morgan Stanley & Co. found Cities spent $7.30 for every barrel of oil, or its equivalent in gas, discovered between 1977 and 1981. Cities' costs were the highest in the group, 91% above the average.